Legal update

No. 15 of 2018 • September 2018 - updated July 2019

momentum

Public Sector Fund benefits

A. Summary

This document describes what public sector funds are and how the benefits from these funds are taxed. It incorporates information from Legal Update 2-2016 (dealing with the changes in the Taxation Laws Amendment Act No. 25 of 2015 that are relevant for the retirement fund industry) and Legal Update 2-2018 (dealing with the relevant changes in the Taxation Laws Amendment Act No. 17 of 2017).

- Paragraph B explains what a public sector fund is.
- Paragraph C gives more information on the Government Employees Pension Fund.
- Paragraph D sets out the history of the taxation of public sector funds.
- Paragraph E describes how Formula C / Paragraph 2A of the Second Schedule to the Income Tax Act should be applied, emphasising that it only applies to the lump sum part of the benefit.
- Paragraph F clarifies why the formula does not apply to an annuity bought by the member.
- Paragraph G deals with the calculation of the tax free portion on transfer, confirming that the "transfer" of the tax-free deduction under the formula only applies on the first and second transfers out of the public sector fund, and not on the third transfer.
- Paragraph H warns against and sets out the consequences of a third transfer.
- Paragraph I explains how the Formula C deduction impacts on a divorce order.
- Paragraph J emphasises the points to keep in mind when dealing with public sector funds.

B. What is a public sector fund?

A public sector fund is a pension fund defined in paragraphs (a) and (b) of the definition of "pension fund" in section 1 of the Income Tax Act.

Paragraph (a) refers to funds established by law, for example the Telkom Pension Fund and municipal funds.

Paragraph (b) refers to any pension fund established for employees of a control board as defined in the Marketing of Agricultural Products Act or for employees of the Development Bank of Southern Africa, where the rules of those funds are similar to the rules of the Government Employees Pension Fund.

The Income Tax Act does not require that the rules of these funds limit a member's lump sum retirement benefit to one-third. If the fund rules allow for it, a member of such a fund is allowed to take more than one-third of his retirement benefit in a lump sum; he may even take his whole retirement benefit in a lump sum, similar to a provident fund.

A public sector fund which allows for more than one-third of the retirement benefit to be taken in a lump sum is classified as a "provident fund" in the Second Schedule to the Income Tax Act.

C. Government Employees Pension Fund (GEPF)

The GEPF is included under paragraph (b) of the definition of "pension fund" in section 1 of the Income Tax Act.

The Rules of the GEPF (contained in the Government Employees Pension Law) provide that if the member has less than 10 years' service at retirement, he can take his whole retirement benefit in a lump sum. If he has more than 10 years' service, he becomes entitled to a once-off lump sum, called a gratuity, and a monthly pension, which is paid for the life-time of the pensioner. The member does not have the option to transfer the retirement benefit to a compulsory annuity/living annuity.

Rule 14.4.1(b) of the Rules of the GEPF, read together with the definition of "approved retirement fund" in the Government Employees Pension Law, allows for the transfer of a resignation benefit to a fund which has been registered as a pension fund organisation in terms of the Pension Funds Act and approved as a pension fund, retirement annuity fund and provident fund in terms of the Income Tax Act. Rule 12.3 suggests that this includes transfers to preservation funds.

Before 1 March 2006, the transfer benefit from the GEPF consisted of two components: the resignation benefit component and the actuarial component. The resignation benefit was taxed as explained under paragraph D below, and was then transferred (post tax) along with the actuarial benefit to an approved retirement fund.

Transfers from the GEPF are usually done to a pension preservation fund or a retirement annuity fund, which means that on retirement, the one-third restriction will apply.

D. Taxation of public sector fund benefits

Before 1 March 1998, the lump sum benefits paid from public sector funds were not taxable. The Income Tax Act No. 28 of 1997 introduced tax on public sector funds from 1 March 1998. This only applied to benefits built up from 1 March 1998 (commonly referred to as 'pre-1998 vested rights'). To determine what portion of a member's lump sum benefit was to be taxed, Formula C was introduced in the Second Schedule to the Income Tax Act, which deals with the *computation of gross income derived by way of lump sum benefits*. The formula was moved to paragraph 2A under the Taxation Laws Amendment Act No. 22 of 2012.

Paragraph 2A, read together with paragraphs 2(1) and 2C, sets out what part of a public sector fund's member's lump sum retirement benefit must be included in a member's "gross income" as defined in section 1 of the Income Tax Act. Amounts included will form part of the member's taxable income.

Paragraphs 5 and 6 of the Second Schedule set out what amounts should be deducted from lump sum benefits before the tax tables are applied. Paragraph 5 applies to retirement benefits, while paragraph 6 applies to withdrawal.

Section 52 of the Taxation Laws Amendment Act No. 8 of 2007 amended paragraph 6 of the Second Schedule to provide that the tax-free amount calculated under the old Formula C would be allowed as a deduction before the tax on a **withdrawal** benefit is calculated, if a benefit has been transferred from a public sector fund to a pension fund, provident fund or retirement annuity fund. That amendment came into operation on 1 March 2006 and applied to a lump sum benefit received or accrued on or after that date. The implication of that amendment was that the deduction would only apply to transfers from 1 March 2006.

Section 62 of the Taxation Laws Amendment Act No. 17 of 2009 expanded these deductions to apply to transfers to “such funds”. Section 84 of the Taxation Laws Amendment Act No. 7 of 2010 changed “such funds” to “a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund”. The amendment came into operation on 1 March 2009 and applied to a lump sum benefit received or accrued on or after that date, which means that it applied to benefits transferred on or after 1 March 2009.

Section 61 of the Taxation Laws Amendment Act No. 17 of 2009 amended paragraph 5 of the Second Schedule to provide that the tax-free amount calculated under the old Formula C would be allowed as a deduction before the tax on a **retirement** benefit is calculated, if a benefit has been transferred from a public sector fund to a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. That amendment came into operation on 1 March 2009 and applied to a lump sum benefit received or accrued on or after that date. The result of that amendment was that the deduction would only apply to transfers from 1 March 2009 and only on the **first** transfer from the public sector fund.

The Taxation Laws Amendment Act No. 17 of 2017 changed paragraphs (5) and (6) to allow for the deduction to apply on one additional transfer. This meant that if a member in a public sector fund transferred to a pension fund after 1 March 2009 and now transferred to another pension fund after 1 March 2018, he would be entitled to the deduction of the tax free amount determined under the formula in paragraph 2A of the Second Schedule.

This is the summary of the history explained above:

Amendment Act	Change	Effective date
ITA No. 28 of 1997	Public sector fund benefits taxed	1 March 1998
TLAA No. 8 of 2007	Tax free benefit carried forward to **first** transfer to pension fund, provident fund or retirement annuity fund qualifies as deduction on **withdrawal** (par 6)	1 March 2006
TLAA No. 17 of 2009 & 7 of 2010	Tax free benefit carried forward to **first** transfer to pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund qualifies as deduction on **retirement** (par 5) and **withdrawal** (par 6)	1 March 2009
TLAA No. 17 of 2017	Tax free benefit carried forward to **second** transfer to pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund qualifies as deduction on retirement and withdrawal	1 March 2018

E. Applying Formula C / Paragraph 2A of the Second Schedule to the Income Tax Act in the public sector fund

To determine which portion of the benefit in the public sector fund will be taxed, one has to use a formula. As stated in the previous paragraph, this formula was defined as formula C in the Second Schedule to the Income Tax Act before the definition was deleted and the formula moved to paragraph 2A. The formula itself did not change.

In short, the formula is:

$$A = \underline{\ B\ } \times D$$

$$\overline{\quad C \quad}$$

where

A = taxable amount to be determined

B = *completed years of employment / service after 1 March 1998

C = total number of completed years of service

D = **lump sum benefit.**

***** completed years of employment after 1 March 1998 or completed years of employment approved after 1 March 1998 during which the member had been a member of the public sector fund, including previous or other periods of service approved as pensionable service in terms of the rules of the public sector fund after 1 March 1998.

Note:

This formula only applies to **lump sum** benefits payable to a member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. It is only that part of a member's benefit that he takes in a **lump sum** at **retirement** that is subject to the formula; not the member's **total** benefit.

On **resignation**, the formula is applied to the amount that accrues to the member, which would be the full resignation benefit if the member resigns from the fund, irrespective of whether that resignation benefit is taken as a lump sum or transferred to another approved fund.

On the **death** of the member, the formula is applied to the lump sum death benefit payable, which is taxed in the hands of the deceased member as if the deceased member received the benefit the day immediately prior to death.

Example:

A was a member of a public sector fund from 1 February 1986.

On 31 May 2018, he retires from the fund with a total benefit of R5 000 000.

The rules of the fund allow him to take his whole retirement benefit as a lump sum.

To determine the **maximum tax free amount**, one has to assume that the member takes his whole benefit in a lump sum.

Lump sum benefit	R5 000 000
Number of completed years' service until 01/03/1998	12
Number of completed years' service from 01/03/1998	20
Total number of completed years' service	32

Applying the formula:

$$\frac{20}{32} \text{ x } 5\ 000\ 000$$

= R3 125 000.

R3 125 000 of his total benefit will be subject to tax. Assuming that the member does not qualify for any other deductions under paragraph 5 of the Second Schedule to the Income Tax Act and also did not receive any other benefits from a retirement fund, the retirement tax table will apply on the taxable benefit of R3 125 000:

Taxable income from lump sum benefits	Rate of tax
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

Tax = R130 500 + 36% of R2 075 000
= R130 500 + R747 000
= R877 500.

In this example, the member will pay tax of R877 500 on the taxable part of his benefit. He gets R1 875 000 tax free under the formula. On his total lump sum benefit of R5 000 000, he will only pay tax of R877 500 and will get a lump sum benefit of R4 122 500 in his pocket.

The member cannot decide to only take his tax free portion of R1 875 000 as calculated under the formula as a lump sum. That would be doing the calculation in reverse.

Only that portion of the benefit taken as a **lump sum** will be subject to the formula. If the member decides to take R1 875 000 as a lump sum (following the previous calculation) and buy an annuity with the rest, then only the lump sum of R1 875 000 will be subject to the formula. The result of that calculation will then be:

Applying the formula:

$$\frac{20}{32} \times \text{R1 875 000}$$

= R1 171 875.

In this case, R1 171 875 of the R1 875 000 will be subject to tax and the member will only get the balance of R703 125 of the lump sum of R1 875 000 tax free. Assuming that the member does not qualify for any other deductions under paragraph 5 of the Second Schedule to the Income Tax Act and he also did not receive any other benefits from a retirement fund, the retirement tax table will be applied as follows:

Taxable income from lump sum benefits	Rate of tax
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

Tax = R130 500 + 36% of R121 875
= R130 500 + R43 875
= R174 375.

The member will then pay tax of R174 375 on R1 171 875 (the taxable part of his benefit). He gets R703 125 tax free under the formula. On his total lump sum benefit of R1 875 000, he will pay tax of R174 375 and will get a lump sum benefit of R1 700 625 in his pocket. He will also have to pay tax on the annuity that he bought with the balance of his benefit, which is R3 125 000 (R5 000 000 total benefit – R1 875 000 lump sum).

F. Does the formula apply to an annuity bought by the member?

The short answer is: No.

Section 10C(2) of the Income Tax Act (the Act) states the following:

"(2) There shall be exempt from normal tax in respect of the aggregate of compulsory annuities payable to a person ***an amount equal to so much of the person's own contributions*** *to any pension fund, provident fund and retirement annuity fund that did not rank for a deduction against the person's income in terms of section 11F as has not previously been —*

(a) allowed to the person as a deduction in terms of the Second Schedule; or

(b) exempted from normal tax in terms of this section,

in respect of any year of assessment."

This means that the provision above can only be applied on the excess of own contributions which were not previously allowed as a deduction under section 11F of the Act or under paragraphs 5 and 6 of the Second Schedule to the Act, and not to any other deductions referred to in paragraphs 5 and 6.

Paragraph 5(1)(*e*) of the Second Schedule to the Income Tax Act states the following:

"5. (1) The deduction to be allowed for the purposes of paragraph 2 (1) (a) is an amount equal to so much of—

(e) any other amounts in respect of which the formula in paragraph 2A applies, which have been –

(i) paid into a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund for the person's benefit by a public sector fund; and

(ii) transferred into a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund directly from a fund contemplated in sub item (i) for the person's benefit,

less the amount represented by symbol A when so applying that formula,

as has not been exempted in terms of section 10C or has not previously been allowed to the person as a deduction in terms of this Schedule in determining the amount to be included in that person's gross income."

This only refers to amounts transferred from a public sector fund to another approved fund and not to contributions made by an individual to an approved pension fund or retirement annuity fund under section 11F of the Act.

Taking the above into account, the conclusion is that the exemption provision under section 10C of the Act cannot be applied to amounts transferred from a public sector fund to another approved fund, where the member buys an annuity to the value of the full lump sum benefit payable by the fund.

G. Calculation of tax free portion on transfer

Paragraphs 5 and 6 of the Second Schedule to the Income Tax Act allow for the "transfer" of the tax free amount determined with the formula when a member transfers his benefit from a public sector fund to a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund. When the member then withdraws or retires from the receiving fund, he will be entitled to deduct that tax-free portion from his withdrawal/retirement benefit, in addition to all the other deductions allowed under paragraph 5 (for retirement benefits) or paragraph 6 (for withdrawal benefits). This deduction of the pre-March 1998 tax-free built up only applies on **two** transfers from the public sector fund.

This is how the tax free portion is calculated by the transferring fund:

Lump sum transferred – amount determined under the formula = tax-free amount.

The transferring fund provides the receiving fund with the amount calculated as being the tax-free amount, which the receiving fund must then reflect on their record for this member.

The impact of the member's choices on transferring to another fund is explained by this example.

A was a member of a public sector fund from 1 February 1986.

On 31 May 2018, he transfers his benefit of R5 000 000 from the public sector fund to another fund.

Calculation of tax free benefit in the public sector fund:

Lump sum benefit	R5 000 000
Number of completed years' service until 01/03/1998	12
Number of completed years' service from 01/03/1998	20
Total number of completed years' service	32

Applying the formula:

$$\frac{20}{32} \text{ x } 5\ 000\ 000$$

= R3 125 000.

R3 125 000 of his total benefit would be subject to tax. The balance of R1 875 000 (R5 000 000 - R3 125 000) would be tax free.

His benefit when he leaves the receiving fund a year later is R5 100 000.

Option 1:

- Transfers to provident preservation fund.
- Retires.
- Takes the whole benefit in a lump sum.

Calculation of tax on retirement benefit of R5 100 000:

First, the tax free amount of R1 875 000 must be deducted from his lump sum. Assuming that there were no other allowable deductions, the remaining R3 225 000 would then be taxed on the retirement tax table:

Taxable income from lump sum benefits	Rate of tax
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

Tax = R130 500 + 36% of R2 175 000
= R130 500 + R783 000
= R913 500.

The member will pay tax of R913 500 on his total benefit of R5 100 000 and will get a benefit of R4 186 500 in his pocket.

Option 2:

- Transfers to **pension** preservation fund or a **retirement annuity fund**.

- Retires.
- Takes the maximum (one-third) in a lump sum.

His lump sum is limited to R1 700 000. The deduction of the tax-free public sector fund amount can only be applied against his lump sum. Since his total lump sum benefit is less than the tax free amount transferred from the public sector fund, he can only deduct R1 700 000 of the R1 875 000, effectively losing the balance of R175 000. Unless he has another retirement fund benefit where the R500 000 tax free amount under the retirement table can be claimed, he also loses that. He therefore loses access to an additional R675 000 tax-free lump sum due to the transfer to the pension preservation fund rather than a provident preservation fund.

Option 3:

- Transfers to **pension** preservation fund.
- Withdraws everything in a lump sum.

Calculation of tax on withdrawal benefit of R5 100 000:

First, the tax free amount of R1 875 000 must be deducted from his lump sum. Assuming that there were no other allowable deductions, the remaining R3 225 000 would then be taxed on the resignation tax table as follows:

Taxable income from lump sum benefits	Rate of tax
0 – R25 000	0%
R25 001 – R660 000	18% of the amount above R25 000
R660 001 – R990 000	R114 300 + 27% of the amount above R660 000
R990 001 and above	R203 400 + 36% of the amount above R990 000

Tax = R203 400 + 36% of R2 235 000
= R203 400 + R804 600
= R1 008 000.

The member will pay tax of R1 008 000 on his total benefit of R5 100 000 and will get a benefit of R4 092 000 in his pocket.

Option 4:

- Transfers to **pension** preservation fund.
- Withdraws R1 000 000 one year later.
- Retires and takes the maximum (one-third) in a lump sum.

Tax on withdrawal benefit: The withdrawal benefit of R1 000 000 is less than the tax free amount of R1 875 000. If the pension preservation fund indicates the tax free amount on the tax directive application, the member will not pay any tax on the withdrawal benefit of R1 000 000. The balance of the tax free benefit (R1 875 000 – R1 000 000 = R875 000) will then be available to the member when he retires.

Tax on retirement benefit: Assume that the retirement benefit is R4 200 000. He is entitled to take one-third of that in a lump sum. This equates to R1 400 000.

First, the balance of the tax free amount of R875 000 must be deducted from his lump sum. Assuming that there were no other allowable deductions, the remaining R525 000 would then be taxed on the retirement tax table as follows, provided that the pension preservation fund indicates the previous withdrawal and the tax free amount on the tax directive application:

Taxable income from lump sum benefits	Rate of tax
0 – R500 000	0%
R500 001 – R700 000	18% of the amount above R500 000
R700 001 – R1 050 000	R36 000 + 27% of the amount above R700 000
R1 050 001 and above	R130 500 + 36% of the amount above R1 050 000

Tax = 18% of R25 000
= R4 500.

The member got R1 000 000 as a withdrawal benefit, with no tax paid, and R1 400 000 as a retirement lump sum, on which he paid R4 500 tax. In total, he got R2 395 500 (R2 400 000 – R4 500) in his pocket.

The differences between the four options can be summarised as follows:

Option	1: Transfer to provident preservation fund, take full retirement benefit as lump sum	2: Transfer to pension preservation fund or retirement annuity fund, take maximum (one-third) of retirement benefit as lump sum	3: Transfer to pension preservation fund, take full withdrawal benefit as lump sum	4: Transfer to pension preservation fund, take one withdrawal benefit, and maximum (one-third) of retirement benefit as lump sum
Money in pocket	R4 186 500	R1 700 000	R4 092 000	R2 395 500
Tax paid	R913 500	R0	R1 008 000	R4 500

H. Consequences of third transfer

The "transfer" of the tax-free deduction under the formula only applies on the first and second transfers out of the public sector fund. If for instance a member transfers his benefit from GEPF to ABC Pension Preservation Fund and then retires from that preservation fund, the deduction will still apply. ABC Pension Preservation Fund must make sure that when such a transfer comes in, they receive the details of the tax free amount.

If the benefit is transferred a second time, the deduction will still be available to the member. If the member above transfers from GEPF to ABC Pension Preservation Fund and then from that preservation fund to JKL Pension Preservation Fund, the deduction will accompany this second transfer.

If the benefit is transferred a third time, the deduction will not be available to the member anymore. If the member above transfers from GEPF to ABC Pension Preservation Fund, then from that ABC Pension Preservation Fund to JKL Pension Preservation Fund and then from JKL Pension Preservation Fund to XYZ Pension Preservation Fund, the deduction will not accompany the third transfer. When he then becomes entitled to a benefit from XYZ Pension Preservation Fund, only the other deductions allowed under paragraphs 5 and 6 will apply to him; the public sector tax free portion deduction will not be available to him. JKL Pension Preservation Fund must in this case make sure that the member fully understands the consequences of the third transfer before such a transfer is allowed, especially if the tax free amount is significant. The member should sign a document stating that the tax consequences of such a third transfer has been explained to him, that he fully understands those consequences and that he still wants to transfer.

I. Impact of the Formula C deduction on divorce

When a member of a public sector fund gets divorced and his pension interest is divided, both the member and the non-member spouse will fully retain the exemption for years of service before 1998.

The Media Statement issued on 13 March 2012 on the *National Budget Review, 2012: Taxation of divorce order-related Retirement benefits*, stated as follows on p3:

> *Note that when applying for a tax directive in respect of pension interest payable by a public sector fund, the retirement fund or administrator must include the pre-1 March 1998 years of service of the member ex-spouse when applying for the tax directive in the name of the non-member ex-spouse. The intention is to apply Formula C to pension interest payable by the public sector fund to either the non-member or the member ex-spouse on a continuing basis.*

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012, published on 10 December 2012, contains the following paragraph on p8:

> *B. The GEPF and other public sector funds*
>
> *Given the changed regulatory environment for public sector funds, it is proposed that all public sector fund members be placed on an equal footing with private sector fund members in tax terms, thereby fully implementing the "clean-break principle." Both ex-spouses will now be taxed in accordance with their own economic interests. Furthermore, it is proposed that the exemption for pre-1998 years of service be fully retained by both ex-spouses. Hence, both the member and the member's ex-spouse will retain the relief to the extent the retirement fund pay-out relates to pre-1998 years of service.*
>
> ***Example***
>
> ***Facts:*** *Mr A joins Government in 1990. He remains in service until 2014. In 1992 he marries Ms D. They get divorced in 2008. According to the divorce order, Ms D is entitled to 40 per cent of Mr A's retirement interest as at the date of divorce. On the date of divorce, Mr A's retirement interest is valued at R2 000 000. Ms D is therefore entitled to R800 000. In 2012, Ms D elects to receive the benefit, and the retirement fund pays Ms D R800 000 less any tax liability.*
>
> ***Results:*** *With regards to the application of the relief in respect of pre-1998 years, the calculation of the taxable amount will be:*

Completed years of service of the member post-1998 as at date of the lump sum becoming payable (1998 – 2012)	*14 years*
Total completed years of service of the member as at date of the lump sum becoming payable (1990 – 2012)	*22 years*
Value of lump sum becoming payable	*R800 000*

$$\frac{\text{14 years}}{\text{22 years}} \times \text{R800 000,}$$

= R509 091 (taxable lump sum)

The amendments to the Second Schedule of the Income Tax Act were made in the Taxation Laws Amendment Act no 22 of 2012.

Paragraph 2(1)(b)(iA) of the Second Schedule provides as follows with regards to the amount to be included in a non-member spouse's gross income:

> *2. (1) Subject to section 9(2)(i) and paragraphs 2A and 2C, the amount to be included in the gross income of any person in terms of paragraph (e) of the definition of "gross income" in section 1 shall be—*

> (b) *any amount—*
>
> (iA) *assigned in terms of a divorce order granted on or after 13 September 2007 under section 7 (8) (a) of the Divorce Act, 1979 (Act No. 70 of 1979), to the extent that the amount so assigned—*
>
> (aa) *constitutes a part of a pension interest, as defined in section 1 of the Divorce Act, 1979 (Act No. 70 of 1979), of a member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund; and*
>
> (bb) *is due and payable on or after 1 March 2012 to a person who is the former spouse of that member by that pension fund, pension preservation fund, provident fund or provident preservation fund or retirement annuity fund.*

Paragraph 2A of the Second Schedule addresses the protection of pre-1998 public sector fund benefits as follows:

> 2A. *Where any lump sum benefit is received or accrues from a public sector fund, the amount to be included in the gross income of any person in terms of paragraph (e) of the definition of "gross income" in section 1 shall be deemed to be an amount equal to the amount determined in accordance with the following formula:*
>
> $$A = \frac{B}{C} \times D,$$

This paragraph stipulates that the formula will be applied to a lump sum benefit paid from a public sector fund that is added to a person's gross income in terms of paragraph (e) of the definition of "gross income" in section of the ITA.

Paragraph (e) of the definition of "gross income" in section of the ITA includes *a retirement fund lump sum benefit or retirement fund lump sum withdrawal benefit* in a person's gross income.

"Retirement fund lump sum withdrawal benefit" as defined in section 1 of the Income Tax Act refers to *an amount determined in terms of paragraph 2(1)(b) of the Second Schedule.*

This full circle that started with paragraph 2(1)(b) of the Second Schedule, skipped to paragraph 2A of the Second Schedule and then took a detour through the definitions of "*gross income*" (par (e)) and "*retirement fund lump sum withdrawal benefit*", and finally came back to paragraph 2(1)(b) of the Second Schedule, confirms that Formula C should be applied to pension interest payable by a public sector fund to member and the non-member spouse.

J. Keep in mind

- Paragraph 2A of the Second Schedule only applies to a **lump sum** benefit.
- The "transfer" of the tax-free deduction under the formula only applies on the first and second transfers out of the public sector fund. On a third transfer, the deduction will no longer be available to the member.
- In transferring from a public sector fund which allows the member to take his whole retirement benefit in a lump sum to a pension fund or retirement annuity fund, the member effectively limits himself to a one-third lump sum benefit, which can potentially limit the tax free amount. Refer to option 2 under paragraph G above.

- Under certain circumstances, it might be in a GEPF member's best interest to not transfer to an "approved retirement fund" shortly before his retirement, but to rather take a retirement benefit from the GEPF.

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